DESCRIPTION OF TAX BILLS

(S. 788, S. 983, AND S. 1781)

Scheduled for a Hearing

Before the

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

of the

SENATE COMMITTEE ON FINANCE

On November 13, 1987

Prepared by the Staff

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of three tax bills scheduled for a public hearing on November 13, 1987, before the Senate Finance Subcommittee on Taxation and Debt Management. The hearing will focus on (1) S. 788 (relating to Indian enterprise zones); (2) S. 983 (relating to rural enterprise zones), and (3) S. 1781 (relating to charitable deduction for contributions of debt of developing nations for international conservation purposes).

The first part of the document is a summary. The second part is a description of S. 788 and S. 983. The third part is a description of S. 1781.

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[1] This document may be cited as follows: Joint Committee on Taxation, Description of Tax Bills (S. 788, S. 983, and S. 1781) (JCX-20-87), November 12, 1987.

II. SUMMARY

S. 788 and S. 983--Indian and Rural Enterprise Zones

Present Law

Tax incentive provisions

Targeted area

The Internal Revenue Code does not contain general rules for targeting areas for special tax treatment. Within certain Code sections, however, there are definitions of targeted areas for limited purposes. For example, the provisions relating to qualified mortgage bonds define targeted areas for the purpose of promoting housing development within economically distressed areas.

Tax credits for employers

There are no general provisions in present law under which an employer's tax liability varies according to the location of its employees. The targeted jobs tax credit in present law does, however, provide a targeted jobs tax credit for a portion of wage payments made to certain groups of employees.

Investment tax credit

An investment tax credit is allowed under present law for qualified rehabilitation of structures: 20 percent for rehabilitation of a certified historic structure and 10 percent for rehabilitation of a building originally placed in service before 1936.

Under prior law, a 10-percent investment tax credit applied to eligible tangible personal property used in a trade or business or for the production of income. The basis of the property was reduced by one-half of the amount of the credit.

Capital gains

Net capital gains are taxed as ordinary income under present law, except that the maximum tax rate on net capital gains in 1987 is 28 percent. Before 1987, net gains from the sale or exchange of a capital asset were taxable at a reduced rate. Noncorporate taxpayers could reduce net capital gains by 60 percent, and the remainder was taxed as ordinary income--effectively establishing a maximum 20-percent rate. The maximum tax rate for corporate capital gains was 28 percent.

Private activity bonds

Although interest on State or local government bonds used to finance trade or business activity generally is taxable, various exceptions are provided, including bonds issued as qualified small-issue bonds, qualified redevelopment bonds, or to finance certain other private activities. Issuance of private activity bonds generally is subject to State volume limitations.

Non-tax provisions

Foreign trade zones

A foreign trade zone may be established within any port of entry. Duties are not levied on imported goods shipped into a foreign trade zone until and unless such goods are sent into other United States territory.

Regulatory flexibility

Present law provides that certain regulatory procedures are to be followed in order to ease the regulatory burden on small businesses, small nonprofit organizations, and small governmental jurisdictions.

Overview of Bills

Designation of enterprise zones

The bills (S. 788 and S. 983) would authorize designation of enterprise zones, for Indians and rural areas, respectively. Special tax incentives and other benefits would be available in the designated zones.

Indian enterprise zones would be designated by the Secretary of the Interior after nomination by an Indian tribal government. Rural enterprise zones, which could include such zones in an Indian reservation, would be designated by the Secretary of Housing and Urban Development. Each zone would have to satisfy various requirements concerning demographic and physical characteristics and levels of poverty, unemployment, and economic distress.

In both bills, State and local, and Indian tribal, governments seeking designation of a nominated area as an enterprise zone would be required to commit to specific actions with respect to the zones to enhance their development. These actions would include (1) reduction of tax rates and fees, (2) increasing efficiency levels of local services, (3) reduction or simplification of governmental requirements applicable to the zones, and (4) involving local private entities in the programs, including commitments to provide jobs and job training and other related technical or

financial assistance for employers, employees, and residents of the designated areas.

Tax incentive provisions

Employment tax credits

Both bills would provide a 10-percent tax credit for employers who increased employment expenditures in the designated zones.

In addition, S. 788 would provide a credit on qualified wages of each qualified ecnomically disadvantaged individual. The credit would be 50 percent of wages during the first 36 months of employment and would phase out completely after 7 years of employment.

Capital gains and losses

S. 788 would exclude from gross income capital gain on qualified Indian enterprise zone property.

S. 983 would provide that gain on sale of rural enterprise zone property would not be recognized if the taxpayer used the proceeds within 12 months to acquire other rural enterprise zone property.

Private activity bonds

Both bills would repeal the present-law sunset date applicable to qualified small-issue bonds and would allow accelerated cost recovery methods to be used instead of straight-line depreciation for property financed with private activity bonds for use in designated zones.

S. 788 also would permit Indian tribal governments to issue private activity bonds in addition to those bonds they may issue currently for essential governmental functions.

Investment tax credit

S. 788 would restore the investment tax credit for Indian enterprise zone property. A 5-percent credit would be allowed for zone personal property. A credit of 10 percent would be allowed for new zone construction property. Zone infrastructure would be allowed a 20-percent credit.

Tax simplification

S. 983 contains a Sense of the Congress resolution that would require the Secretary of the Treasury to simplify administration and enforcement of Code provisions amended by the bill.

Other provisions

Foreign trade zones

S. 788 and S. 983 would require the Foreign Trade Zone Board to expedite any application involving establishment of a foreign trade zone within an Indian, or rural, enterprise zone. The Secretary of the Treasury would be required to expedite applications to establish ports of entry in an enterprise zone (needed to establish a foreign trade zone).

Other provisions in S.788

A provision would be provided to encourage conflict resolution in an Indian enterprise zone. Additionally, the Indian Self-Determination and Educational Assistance Act would be amended by allowing an additional 5 percent of the amount paid on any Federal contract with respect to a subcontractor which is an Indian organization or an Indian-owned organization to be added to the contract price.

Other provisions in S. 983

Federal agencies would be directed to pursue regulatory flexibility by modifying or waiving agency rules that relate to an activity carried on in a rural enterprise zone.

Similarly, Federal agencies would be directed to provide special assistance to rural enterprise zones in the form of rules to expedite processing, establish priority funding and program set-asides, and provide technical assistance in furtherance of the bill's purposes.

S. 1781--Charitable Deduction for Debt of Developing Countries

Present Law

A charitable contribution deduction arising from the donation of depreciated property is generally measured by the fair market value of the property. If the loss inherent in the property would be deductible to the donor upon realization, however, a greater combined deduction can be achieved by realization of the loss followed by a donation of cash equal to the fair market value of the property.

Overview of Bill

The bill provides that certain charitable contributions of instruments evidencing debt of certain foreign countries will give rise to deductions no less than the donor's basis in the instrument. To qualify for this treatment, the bill requires that the donee promise to use the gift for a conservation purpose relating to the debtor country.

II. DESCRIPTION OF S. 788 AND S. 983

A. Present Law

Tax incentive provisions

Targeted area

The Internal Revenue Code does not contain general rules for targeting areas for special tax treatment. Within certain Code sections, however, there are definitions of targeted areas for limited purposes. The provisions relating to qualified mortgage bonds define targeted areas for the purpose of promoting housing development within economically distressed areas. Within such areas, which are defined on the basis of the income of area residents or the general economic conditions, rules for the financing of owner-occupied homes with qualified mortgage bonds are less restrictive than the generally applicable rules.

Tax credits for employers

There are no provisions in present law under which an employer's tax liability varies according to the location of its employees. The targeted jobs tax credit in present law provides a tax credit for a portion of wage payments made to certain groups of employees. These groups generally are defined according to the employees' physical condition, participation in a specified education or rehabilitation program, or economic status.

Investment tax credit

An investment tax credit (ITC) is allowed under present law for qualified rehabilitation of structures: 20 percent for rehabilitation of a certified historic structure and 10 percent for rehabilitation of a building originally placed in service before 1936. A full basis adjustment is required for both credits.

Before 1986, a 10-percent ITC applied to eligible tangible personal property used in a trade or business or for the production of income. The basis of the property was reduced by one-half of the amount of the credit. The ITC was not allowed for real property.

Capital gains

Net capital gains are taxed as ordinary income under present law, except that the maximum tax rate on noncorporate net capital gains in 1987 is 28 percent. Before 1987, net capital gain from the sale or exchange of a capital asset was taxable at a reduced rate. Noncorporate taxpayers could reduce net capital gains by 60 percent, and the remainder was

taxed as ordinary income--effectively establishing a maximum 20 percent rate. The net capital gains tax rate for corporations was 28 percent. Capital assets generally include any property held by the taxpayer with the exception of property used, or held for sale, in the taxpayer's trade of business. This reduction in tax was treated as a preference item for purposes of the noncorporate and corporate minimum taxes.

Private activity bonds

Although interest on State or local government bonds used to finance trade or business activity generally is taxable, various exceptions are provided, including bonds issued as qualified small-issue bonds, qualified redevelopment bonds, or to finance certain other private activities. Issuance of private activity bonds by States and local governments generally is subject to State volume limitations. The exemption for qualified small-issue bonds, expires after December 31, 1989.

Property financed with tax-exempt private activity bonds generally is allowed cost recovery deductions using the straight-line method over recovery periods longer than those otherwise allowed.

Indian tribal governments may issue tax-exempt bonds only for essential governmental functions; tribal governments may not issue private activity bonds.

Non-tax provisions

Foreign trade zones

A foreign trade zone may be established within any port of entry. Duties are not levied on imported goods shipped into a foreign trade zone until and unless such goods are sent into other United States territory.

Regulatory flexibility

Present law provides that certain regulatory procedures are to be followed in order to ease the regulatory burden on small businesses, small nonprofit organizations, or small governmental jurisdictions.

B. Explanation of S. 788 (The Indian Economic Development Act of 1987)

Designation of Indian enterprise zones

Definition of zone

Under the bill, an "Indian enterprise zone" would be any area which is nominated for designation by a tribal government and which is so designated by the Secreatry of the Interior (after consultation with the Secretaries of Commerce, Labor, Housing and Urban Development, and Treasury, and the Administrator of the Small Business Administration).

The Secretary of the Interior (Interior) would be required to prescribe regulations, not later than four months after the enactment of the bill, providing the procedures for nominating an area as an Indian enterprise zone, the parameters relating to the size and population characteristics of an Indian enterprise zone, and the manner in which nominated areas would be compared based on factors such as the tribal governments' commitments to reduce various burdens borne by employers or employees in such areas, and the levels of poverty, unemployment, and general distress in such areas.

Interior would have authority to designate nominated areas as Indian enterprise zones only during a three-year period following the month in which regulations published pursuant to the bill first become effective.

Period of effect of designation

Any designation of an area as an Indian enterprise zone would remain in effect until the earliest of (1) the end of 24 calendar years following the year in which the designation was made; (2) the termination date selected by the tribal government; or (3) the date Interior revoked the designation for failure to comply with the commitments made in seeking the designation.

Interior could revoke the designation of an area if the tribal government was not complying substantially with commitments it made in seeking the designation. Before revoking a designation, Interior would be required to consult with the Secretaries of Commerce, Labor, Housing and Urban Development, and the Treasury, and the Administrator of the Small Business Administration.

Requirements for designation

A nominated area could not be designated as an Indian enterprise zone unless:

(1) The area is within the jurisdiction of the tribal government. (An adjacent portion outside the jurisdiction of the tribal government would be treated as if it were within that jurisdiction so long as the adjacent portion was not more than twice as large as the nominated area actually within the jurisdiction of the tribal government.)

(2) The boundary of the area is continuous.

(3) The area is determined by Interior to be "Indian lands," meaning all lands within the boundaries of any Federal Indian reservation and all lands which were determined by Interior to be substantially governed by a tribal government.

(4) The tribal government certified and Interior accepted such certification, that the area is one of pervasive poverty, unemployment, and general distress, and that one of the following criteria was met: (a) the unemployment rate was at least two times the national unemployment rate for the period, or (b) the poverty rate (as determined by the most recent census data available) for each populous tract within the area was at least 20 percent for the period to which such data relate, or (c) at least 70 percent of the households living in the nominated area had incomes below 80 percent of the median income of households of the area generally.

(5) The tribal government agreed that, during any period during which the area was an Indian enterprise zone, such government would follow a specified course of action designated to reduce the various burdens borne by employers or employees in such area. The specified course of action could be implemented by both government and private entities, and could include: (a) a reduction of tax rates, fees, or royalties applying within the Indian enterprise zone; (b) an attempt to increase the level of efficiency of local services (e.g., crime prevention) within the Indian enterprise zone; (c) actions to reduce or streamline governmental requirements applying within the Indian enterprise zone; (d) involvement in the program by private organizations, neighborhood associations and community groups, including a commitment from such private entities to provide jobs and job training for employers, employees, and residents of the nominated area; (e) actions to assure non-tribal interests that their rights will be protected (such as separation of tribal courts from political influence, adoption of model legal codes, and adequate access and rights to the tribal courts; (f) actions to separate tribal business functions from the governmental aspects of the tribe; and (g) formulation of tribal plans, with proper zoning designation and enforcement.

Priority of designation

In choosing the areas to designate, Interior would be allowed to give preference to nominated areas with high levels of poverty, unemployment, and general distress and with respect to which the most commitments had been made (by the tribal government and private entities) to reduce burdens borne by employers or employees in such areas. Interior also would be allowed to give preference to nominated areas, the size and location of which would primarily stimulate new economic activity and minimize unnecessary tax losses to the Federal Government.

Reporting requirements

Interior would be required to prepare and submit to Congress a report on the effects of designating areas as Indian enterprise zones within four years after the year in which the first areas were designated as Indian enterprise zones.

Tax incentive provisions

Employment tax credit

The bill would provide a tax credit to employees for Indian enterprise zone employment. The amount of the credit would be equal to the sum of two amounts: (1) 10 percent of the qualified increase in an employer's employment expenditures and (2) the applicable economically disadvantaged credit amount for the employee. This computation would be made on a taxable year basis and would allow for carrybacks and carryforwards of unused credits.

Not all wages paid by an Indian enterprise zone employer would qualify for the increased employment expenditure portion of the credit. Only the amount of wages paid by an employer in designated Indian enterprise zones during a specified 12-month period, which exceeded the wages paid by that same employer during the immediately previous 12-month period, would be eligible. Also to be qualified wages for purposes of this credit the wages would have to meet the definition of wages currently in the code for (FUTA) employment tax purposes, with some modifications. One such modification would be the exclusion from the wage base of any Federally funded payments the employer received or accrued for on-the-job training. A second difference would relate to special rules for agricultural and railway labor. In no event, however, could qualified wages exceed 2.5 times the wage base for FUTA taxes. (Currently, the FUTA wage base is $7,000.) The bill also would provide that wages would not be taken into account for increased employment expenditures if they otherwise qualified for the economically disadvantaged credit, described below.

The second element of the credit computation would be the economically disadvantaged credit amount which would represent the sum of the applicable percentage of qualified wages paid to each qualified economically disadvantaged individual. The applicable percentage for the first 36 months of employment would be 50 percent. Between the 36th and 84th months of employment, the percentage would be gradually decreased to zero.

The term "qualified economically disadvantaged individual" would be defined as an individual who possessed each of four qualifications. First, the individual would have to be a qualified employee. Second, the individual would have to be hired by an employer in a currently designated area and would have to perform services for that employer in that designated area. Third, the individual would have to be certified as either (1) an economically disadvantaged individual, (2) an eligible work incentive employee, or (3) a general assistance recipient. (This certification would be made by the tribe in a manner similar to that under the targeted jobs credit. (Code sec. 51).) Fourth, the individual would be required to be an enrolled tribal member.

To be a qualified employee an individual would be required to satisfy a two-part test. The first part of the test would require that at least 90 percent of the services of the employee during the taxable year be directly related to the conduct of the employer's trade or business which was located in the enterprise zone. The second part of the test would require that the employee perform at least 50 percent of the services with respect to which the credit related during the taxable years in the Indian enterprise zone.

Investment tax credit for zone property

Under the bill, an investment tax credit would be allowed for certain investments in property that was used in the conduct of a trade or business within an Indian enterprise zone or that benefited the Indian tribal infrastructure.

Zone personal property.--A 5-percent tax credit would be available for all depreciable personal property. To be eligible for this credit, the property would have to be acquired and first placed in service by the taxpayer in an Indian enterprise zone during the period that the designation as an enterprise zone was in effect. In addition, the taxpayer would be required to use the property predominantly in the active conduct of a trade or business (including the rental of real estate) within the Indian enterprise zone and could not acquire the property from a related person.

Property used or located outside the Indian enterprise

zone on a regular basis would not be eligible for the 5-percent credit. The credit rate would be reduced by 25 percent for the taxable year that included the twenty-first anniversary of the Indian enterprise zone designation, and by an additional 25 percent for each year thereafter. The basis of property eligible for the 5-percent credit would be reduced by half the amount of the allowable credit.

New zone construction property.--A 10-percent tax credit would be available for nonresidential real property, residential rental real property, and real property with a class life in excess of 12.5 years if (1) the property was located in the Indian enterprise zone; (2) the property was acquired or constructed by the taxpayer; and (3) the property was used predominantly in the active conduct of a trade or business (including the rental of real estate) within the Indian enterprise zone.

In the case of property acquired by a taxpayer, the credit would be available only if the property was acquired from an unrelated person after the designation of the zone and only if the original use of the property commenced with the taxpayer. In the case of property constructed, reconstructed, rehabilitated, renovated, expanded, or erected by the taxpayer, the credit would be available only to the extent of any construction, etc. after designation of the enterprise zone.

As with the personal property credit, this credit rate would be reduced by 25 percent for the taxable year that included the twenty-first anniversary of the Indian enterprise zone designation, and by an additional 25 percent for each year thereafter. The basis of property eligible for the 10-percent credit would be reduced by the full amount of the allowable credit.

Zone infrastructure investment.--A 20-percent tax credit would be available for Indian enterprise zone property that benefited the Indian tribal infrastructure and that was available to the general public. For purposes of this credit, Indian enterprise zone property would include property located outside the Indian enterprise zone but only if its purpose was to connect to existing tribal infrastructure in the zone. Examples of property eligible for the 20-percent credit would include roads, power lines, water systems, railroad spurs, and communication facilities.

Recapture.--If property for which an Indian enterprise zone credit was claimed by a taxpayer was disposed of, a portion of the enterprise zone credit would be recaptured. In addition, if property for which the 5-percent Indian enterprise zone credit was claimed by a taxpayer was removed from the Indian enterprise zone, or converted or otherwise ceased to be Indian enterprise zone property (other than by

expiration or revocation of the designation of the zone), a portion of the enterprise zone credit would be recaptured.

The amount of the enterprise zone credit subject to recapture would be the difference between the amount of the credit allowed for the property and a recomputed credit based on the amount of time that the property was Indian enterprise zone property of the taxpayer. The recomputed credit would bear the same ratio to the amount of the credit originally allowed as the number of taxable years in which the property was enterprise zone property bore to the number of years over which the property was depreciated for purposes of computing earnings and profits.

Carryover period.--Unused Indian enterprise zone credits could be carried forward for the remaining life of the enterprise zone or 15 years, whichever was longer.

Capital gains exclusion

The bill would exclude qualified capital gains from a taxpayer's gross income. In general, qualified property on which a gain would be excluded would be defined as tangible personal property used by the taxpayer in its business within an Indian enterprise zone or any real property located in an Indian enterprise zone and used by the taxpayer in its business within such a zone. An interest in a corporation or partnership could be qualified property if the corporation or partnership conducted business in an Indian enterprise zone, generated at least 80 percent of its gross receipts from activities carried on within the zone, and had substantially all of its assets located within the zone. Rental real estate would be considered as qualified property. No property could be qualified if it was placed in service within the twelve months prior to the designation of the Indian enterprise zone.

Any property which qualified for the capital gains exclusion, would remain qualified if the designation of the zone expired or was revoked. However, after the first sale or exchange of qualified property following the designation of the zone had expired or been revoked, the property would cease to be qualified.

This exclusion would apply to long-term capital gains, that is, gains on those assets which the taxpayer had held for at least six months. All capital losses and short-term gains would receive present-law treatment.[2]

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[2] Prior to the 1986 Tax Reform Act, a 60-percent exclusion for long-term capital gains was allowed for individuals. At

(Footnote continued)

Private activity bonds

The bill would permit qualified property which was financed with the proceeds of tax exempt bonds to use the accelerated cost recovery system which would apply in the absence of tax-exempt financing in lieu of the alternative depreciation system which generally requires straight-line depreciation over longer recovery periods for tax-exempt bond financed property.

Present law establishes a sunset date of December 31, 1989, for the issue of qualified small-issue manufacturing facility bonds. The bill would revoke the sunset date as it applies qualified small-issue bonds for facilities in Indian enterprise zones.

In addition, Indian tribal governments would be permitted to issue private activity bonds in addition to those bonds they presently may issue for essential governmental functions.[3]

Other provisions

Foreign trade zones

The bill would require the Foreign Trade Zone Board to expedite on a priority basis the processing and approval, to the maximum extent practicable, of any application involving the establishment of a foreign trade zone within an Indian enterprise zone. The Treasury Department would be required to give the same urgent consideration to an application for establishment of a port of entry (necessary to permit the establishment of a foreign trade zone within an Indian enterprise zone).

Conflict resolution in Indian enterprise zones

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[2](continued)
the same time, the individual alternative minimum tax counted this exclusion as a preference item for minimum tax purposes. The 1986 Act repealed the exclusion and deleted capital gains as a preference item for alternative minimum tax purposes. The bill is unclear as to whether this exclusion of a long-term gain would be an includable preference item under the alternative minimum tax.

[3] The bill does not specify the treatment of these Indian tribal government bonds under the State private activity bond volume limitations of present law.

The bill would authorize the Interior Department to approve plans, pursuant to a tribal economic development plan, which included provisions for resolving conflicts between Indian enterprise zone parties. Such plans could provide for binding arbitration of contract and other civil disputes between tribal entities and non-tribal businesses or entities. Interior could not approve any plan, however, if it encumbered or diminished the trust assets of a tribe.

Indian self-determination and education assistance

Under the bill, any person who entered into a contract with a Federal agency under any Federal law would be allowed an additional amount of compensation equal to 5 percent of the amount paid to a subcontractor or supplier if such subcontractor or supplier was (1) an Indian organization, or (2) a commercial, industrial, or business activity organized for profit, which was at least 51 percent Indian-owned.

Effective date

The bill generally would be effective after December 31, 1986.

C. Description of S. 983 (The Rural Enterprise Zone Act of 1987)

Designation of rural enterprise zones

Definition of zone

The bill would amend the Internal Revenue Code to provide criteria for the designation of rural enterprise zones. A rural enterprise zone would be any area which was nominated as such by one or more local governments and the State or States in which it was located, and which was approved by the Secretary of Housing and Urban Development (HUD) after consultation with the Secretaries of Agriculture, Commerce, Labor, and the Treasury, the Director of the Office of Management and Budget, and the Administrator of the Small Business Administration. In the case of a rural enterprise zone on an Indian reservation, the Secretary of the Interior also would have to be consulted.

The term State would include Puerto Rico, the Virgin Islands, Guam, American Samoa, the Northern Mariana Islands, and any other possession of the United States. The term local government would include any county, city, town, township, parish, village or other general purpose political subdivision of a State, any combination of these subdivisions that was recognized by HUD and the District of Columbia. In the case of a nominated area on an Indian reservation, the reservation governing body, as determined by Interior, would be deemed to be both the State and local government.

Before designating any area as a rural enterprise zone, HUD would have to promulgate regulations, after consultation with the above Federal officials, describing (1) the nomination procedures, (2) the size and population characteristics of a rural enterprise zone, and (3) the procedures for comparing nominated areas using the criteria specified below for evaluating commitments made by State and local governments and for establishing priorities to be applied in making designations.

HUD could designate rural enterprise zones only during a 36-month period that began on the later of the first day of the first month after the effective date of the regulations, or January 1, 1988. No more than 45 rural enterprise zones could be designated under this provision, and no more than 18 zones during the first 12-month period it was effective.

HUD could not designate an area as a rural enterprise zone unless the local government and the State in which the nominated area was located had the authority to nominate, to make commitments with respect to the zone, and to assure that the commitments would be fulfilled. HUD also would have to determine that the information submitted with a nomination

was reasonably accurate and that no portion of the nominated area was already included in a rural enterprise zone.

Period designation in effect

Any rural enterprise zone designation would remain in effect from the date of designation to the earliest of December 31 of the calendar year 12 years later, the date stipulated by the State and local governments in their nomination application, or the date the zone designation was revoked by HUD. No designation would take effect until the relevant State or local government submitted to HUD an inventory of historic propoerties within the area. HUD, after consulting with the same Federal officials who would be required to be consulted in designating rural enterprise zones, could revoke a zone designation if it determined that the State or local government was not substantially complying with the required State or local government commitments (described below).

Area and eligibility requirements

HUD could designate an area nominated as a rural enterprise zone, only if it met requirements concerning size, population, area boundaries, unemployment, poverty and other signs of economic distress. A description of these requirements follows:

a. The area would be required to have a continuous boundary and be either (1) within a local government jurisdiction or jurisdictions that were not central cities of a metropolitan statistical area and that have a population of less than 50,000, (2) outside of a metropolitan statistical area, or (3) determined by HUD (after consultation with the Secretary of Commerce) to be rural.

b. The most recent census would be required to show that the area's population was at least 1,000, or the area was entirely within an Indian reservation.

c. The nominating governments would be required to certify that the area was one of pervasive poverty, unemployment and general distress, and was located wholly within a jurisdiction which met the requirements for Federal assistance under section 119 of the Housing and Community Development Act of 1974, as in effect on the date of enactment. In addition, the area would be required to be one in which either (1) the unemployment rate was at least 1-1/2 times the national national unemployment rate, (2) the poverty rate was at least 20 percent, or (3) at least 70 percent of the households living in the area had incomes below 80 percent of the median income of households within the jurisdiction of the local government.

Required State and local government commitments

No area could be designated as a rural enterprise zone unless the local government and the State in which it was located agreed that, during any period that the area was a rural enterprise zone, these governments would follow a specified course of action designed to reduce the various burdens by employers or employees in the area.

This course of action could be implemented by the State and local governments and private nongovernmental entities, and could be funded from the proceeds of any Federal program. The course of action could include, but would not be limited to, (1) a reduction of tax rates or fees applying within the rural enterprise zone; (2) an increase in the level or efficiency of local services within the rural enterprise zone, particularly through experiments with the supply of these services by nongovernmental entities; (3) elimination, reduction or simplification of governmental requirements applying within the rural enterprise zone; and (4) program involvement by private entities, organizations, neighborhood associations and community groups, particularly those within the nominated area (including a commitment from these private entities to provide technical, financial or other assistance to, and jobs or job training for, employers, employees and residents of the area).

Priority of designation

The bill would provide criteria for HUD to use in choosing areas to be rural enterprise zones. HUD would be required to give special preference to those nominated areas for which contributions to a course of action (as described above) had been promised by the nominating governments, taking into account their fiscal ability to provide tax relief. HUD also would be required to give preference to nominated areas with the following characteristics: (1) strongest and highest quality contributions; (2) most effective and enforceable guarantees provided by nominating State and local governments that proposed courses of action actually would be carried out for the duration of the designation; (3) high levels of poverty, unemployment and general distress, particularly areas near concentrations of disadvantaged workers or long-term unemployed individuals for whom employment would be a strong likelihood if the area were designated a rural enterprise zone, (4) zone size and location that would primarily stimulate new economic activity and minimize unnecessary Federal tax losses; (5) most substantial commitments by private entities of additional resources and contributions, including creation of new or expanded business activities; and (6) nominated zones which best exhibited such other factors that would be consistent with the program's intent and important in minimizing unnecessary loss of Federal tax revenues.

Evaluation and reporting requirements

HUD would be required to prepare and submit to Congress a report on the effects of designating qualifying areas as rural enterprise zones in accomplishing the purposes of the legislation not later than the close of the fourth calendar year after the year in which areas are first designated as rural enterprise zones. Subsequent reports would be submitted at four year intervals.

Interaction with other Federal programs

Any reduction of taxes under any required program of State and local commitment under the bill would be disregarded in determining the eligibility of a State or local government for, or the amount or extent of, any assistance or benefits under any Federal law. In addition, the designation of a rural enterprise zone would not consitute approval of a Federal program for purposes of the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 or entitle any person displaced from real property in such zone to any rights or benefits under such Act. Such a designation also would not constitue a Federal action for purposes of applying the requirements of the National Environmental Policy Act of 1969 or other provisions of the law relating to the protection of the environment.

Tax incentive provisions

Wage tax credit

The bill would provide a 10-percent tax credit for employers in designated rural enterprise zones, for certain wages paid to qualified employees. Only the amount of wages paid by an employer in designated rural enterprise zones during a specified 12-month period, which exceeded the wages paid by that same employer during the immediately previous 12-month period, would qualify for the credit. In no event, however, would qualified wages with respect to a qualified employee exceed an amount equal to the lower living standard for a family of four as determined by the Bureau of Labor Statistics for the applicable year. The bill also would provide for an annual inflation adjustment to the qualified wage base amount and the living standard. Qualified wages for purposes of this credit generally would constitute the definition of wages currently applicable Federal unemployment (FUTA) tax purposes, with certain adjustments. One such modification would be the exclusion from the wage base of any Federally funded payments the employer received or accrued for on-the-job training. A second difference would relate special rules for agricultural and railway labor.

For purposes of the credit, an individual would be required to satisfy a two-part test to become a qualified employee. The first part of the test would require that at least 90 percent of the services of the employee during the taxable year be directly related to the conduct of the employer's trade or business which was located in the rural enterprise zone. The second part of the test would require that the employee perform at least 50 percent of the services during the taxable years in the rural enterprise zone.

Capital gains and losses

If the taxpayer sold or exchanged qualified rural enterprise zone property and within twelve months used the proceeds to purchase other such property, the bill would permit the taxpayer to elect nonrecognition treatment of his gain or loss on the sale or exchange. The bill defines qualified rural enterprise zone property as any tangible personal property used predominantly by the taxpayer in his business within a designated rural enterprise zone or any real property located within the zone and used by the taxpayer in his business. Any such property would be required to be placed in service by the taxpayer while the designation of the enterprise zone was in effect.[4]

Any property which qualified for this nonrecognition treatment, would remain qualified if the designation of the zone expired or was revoked. However, after the first sale or exchange of qualified property following the designation of the zone had expired or been revoked, the property would cease to be qualified.

If the taxpayer elected nonrecognition treatment, he or she would be required to adjust the basis of the new property downward by the amount of the gain not recognized, or upward by the amount of the loss not recognized.

Private activity bonds

The bill would permit qualified property which was financed with the proceeds of tax-exempt bonds to use the accelerated cost recovery system which would apply in the absence of tax-exempt financing in lieu of the alternative depreciation system which generally requires straight-line

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[4] The bill defines a "rural enterprise zone business" as one which generated at least 80 percent of its gross receipts from activities carried on within the zone, and had substantially all of its tangible assets located within the zone. It appears the intent of the bill is to define interests in these businesses as qualified property for the purpose of capital gain nonrecognition.

depreciation over longer recovery periods for tax-exempt bond-financed property.

Present law establishes a sunset date of December 31, 1989, for the issue of qualified small-issue manufacturing facility bonds. The bill would revoke the sunset date as it applies bonds funding facilities in a rural enterprise zone, if the facilities were placed in service while the zone designation was in effect. The bill also would permit qualified small-issue bonds to have face amounts in excess of $1,000,000 or $10,000,000 if 95 percent of the proceeds were used to finance facilities within a rural enterprise zone. However, no one beneficiary could receive within an enterprise zone the benefit of more than $40,000,000 from tax-exempt financing over a three-year period.

The bill would require each State which had at least one designated rural enterprise zone to allocate at least five percent of its annual private activity bond volume authority for use within its enterprise zone or zones.

Tax simplification

The bill would provide that it is the sense of the Congress that the Treasury Department simplify the administration and enforcement of any provisions of the Internal Revenue Code of 1986, amended by this bill, as applied to rural enterprise zones.

Other provisions

Regulatory flexibility

The bill would expand the definition of a small entity, for purposes of the Regulatory Flexibility Act, to include any qualified rural enterprise zone business, any government designating an area as an enterprise zone to the extent any regulatory rule would affect the zone, and any not-for-profit enterprise operating within such a zone.

Under the bill, Federal agencies and regulatory bodies would be given discretionary authority to relax or eliminate any regulatory requirements within enterprise zones except those affecting civil rights, safety and public health, or those required by statute, including any requirement of the Fair Labor Standards Act. This authority could be exercised only upon request of State and local governments. Agencies would make their determinations on requests not later than 90 days after their receipt. Such waivers or determinations would not be considered a rule, rulemaking, or regulation under the Administrative Procedure Act.

Coordination of Housing and Urban Development programs in enterprise zones

The bill would provide that HUD would be required to promote the coordination of programs under its jurisdiction and carried on in an enterprise zone and to consolidate requirements for related applications and reports required under these programs.

Establishment of foreign trade zones in rural enterprise zones

The bill would require the Foreign-Trade Zone Board to expedite on a priority basis the processing and approval of any application involving the establishment of a foreign trade zone within a rural enterprise zone. The Treasury Department would be required to give the same urgent consideration to an application for establishment of a port of entry (necessary to permit the establishment of a foreign trade zone within a rural enterprise zone). The bill would direct the Foreign-Trade Zone Board and Treasury, in evaluating applications for the establishment of foreign-trade zones and ports of entry in connection with rural enterprise zones, to approve the applications to the maxiumum extent practicable consistent with their respective statutory responsibilities.

Responsibilities of Federal agencies

The bill would provide that Federal agencies must provide special assistance to rural enterprise zones to the extent permitted by law. Such assistance could include (but would not be limited to) expedited processing, priority funding, program set-asides, and provision of technical assistance. The heads of Federal agencies would be directed to prescribe such regulations as might be necessary or appropriate to carry out the bill's purposes.

Effective date

The bill generally would be effective after December 31, 1986.

III. DESCRIPTION OF S. 1781

A. Present Law

Deduction for charitable contributions--General rules

A deduction is permitted for contributions of cash or property to or for the use of charitable organizations, the United States, or a State or local government (Code sec. 170). The maximum amount of charitable deduction allowable for any one year is subject to limitations generally based on adjusted gross income (in the case of an individual), depending on the nature of property donated and the type of donee organization, or on taxable income (in the case of a corporation), determined in each case without regard to certain deduction items. Contributions in any one year in excess of these limits may be carried forward and deducted over the following five years (subject to applicable percentage limitations in those years).

If appreciated property is contributed, the deduction amount (for purposes of the regular tax) generally equals the fair market value of the property on the date of the contribution. This rule would apply, for example, in the case of a contribution of appreciated stock to a publicly supported charity if the sale of that stock by the donor would have given rise to long-term capital gain. However, to the extent that a sale of the appreciated property by the donor would not have given rise to long-term capital gain (or in certain other situations), the deduction is reduced (sec. 170(e)(1)(A)). For example, the sale of a debt instrument by a bank or certain other financial institutions generally is not considered a sale or exchange of a capital asset (sec. 582(c)). Thus, a charitable contribution of an appreciated debt instrument by a bank would result in a deduction only to the extent of the donor's basis in the instrument.

If a taxpayer sells property to a charitable organization for less than its fair market value--a so-called "bargain sale"--the basis of the property is allocated between the portion of the property "sold" and the portion of the property "donated" to the charity based on the ratio of the sale proceeds to the fair market value of the property (sec. 1011(b)). The proceeds of the sale are treated as taxable gain or loss to the extent of the difference between the sales proceeds and the basis allocated to the sale. The seller is allowed a charitable contribution deduction (subject to the usual rules for donations of property) for the value of the portion of the property "given" rather than "sold." For example, if a taxpayer sold property with a fair market value of $100, and basis of $20, to a charity for $50, half of the property (with basis equal to $10) would be treated as having been sold to the charity for $50, and half

of the property (with fair market value of $50) would be treated as having been donated to the charity.

If a taxpayer makes a charitable contribution of depreciated property, the deduction amount is generally limited to the fair market value of the property on the date of the contribution. Absent a bargain sale, a charitable contribution generally does not constitute a disposition giving rise to taxable gain or loss on the property. Thus, a contribution of property generally does not result in the recognition of the inherent gain or loss that the donor would have realized had the donor sold the property. If a taxpayer owns depreciated property the sale or abandonment of which would give rise to a deductible loss, a charitable donation of such property may produce a smaller deduction (i.e., the fair market value of the property) than would result from sale or abandonment of the property. For example, an abandonment may result in a deduction equal to the basis of the property (sec. 165). As another example, a sale of property at a loss may give rise to a deductible loss equal to the difference between the taxpayer's basis in the property and the sale proceeds; a charitable contribution of the sale proceeds could result in a charitable deduction which, together with the loss deduction, allows the entire basis to be deducted.

Revenue Ruling 87-124

The IRS recently ruled that under certain circumstances the delivery of a depreciated debt obligation to the debtor, followed by receipt of consideration by a charitable organization (rather than the former holder of the obligation), will result for tax purposes in both a loss to the holder and a deductible charitable contribution by the holder. Under the ruling, the sum of the loss and the contribution will equal the holder's adjusted basis in the obligation. Rev. Rul. 87-124 (released Nov. 12, 1987), 1987-47 I.R.B.

The ruling assumes that a foreign country (FC) has a program under which a holder of a U.S. dollar denominated debt obligation of FC can deliver the obligation to FC's central bank in exchange for FC's local currency if the holder agrees to use the currency in FC in a manner approved in advance by the government of FC. In accordance with a prearranged plan pursuant to this program, a U.S. bank holding a dollar obligation of FC's central bank, with an adjusted basis of $100, delivers the obligation to the central bank. The latter credits an account of a U.S. charitable organization with 900 units of local currency. The free market exchange rate at the time is $1 = 10 units of the local currency. The charity can only use the currency in FC for charitable purposes meeting the requirements of Code section 170. The ruling suggests that such a restriction may

reduce the fair market value of the 900 units below $90.

The ruling states that the U.S. bank recognizes a loss on the exchange of the obligation for 900 units of local currency to the extent of the excess of $100 over the fair market value of the currency; further, if the bank and the charity otherwise satisfy all requirements of the Code relating to charitable contributions, the bank is entitled to a charitable contribution deduction equal to the fair market value of the local currency at the time of the contribution.

Qualified conservation contributions

Subject to certain exceptions, no charitable deduction is allowed for contributions of less than the taxpayer's entire interest in the donated property. This restriction does not apply with respect to donations of "qualified conservation contributions," defined as certain interests in real property (such as permanent restrictions on the use which may be made of real property) short of absolute fee interests, if made to certain types of charitable organizations exclusively for conservation purposes (sec. 170(h)).

Information return by donee on disposition of contributed property

If a donee charity sells, exchanges, transfers, or otherwise disposes of any charitable deduction property within two years of the date it received the property, the donee must furnish the IRS with an information return containing the donor's name, address, and tax identification number, a description of the property, the dates of its contribution and disposition, and the amount received on disposition (sec. 6050L). Charitable deduction property is any property other than publicly traded securities (securities for which market quotations are readily available on an established securities market) the contribution of which gave rise to a claimed charitable deduction greater than $5,000.

B. Explanation of the Bill

General rules

The bill would provide that in the case of qualified debt contributions, the amount of any charitable deduction otherwise allowable will be no less than the donor's basis in the contributed debt instrument. Such a deduction is subject, under the bill, to the existing percentage limitations on charitable contributions in any taxable year. Thus in the case of a depreciated debt instrument held by a bank and donated as qualified debt contribution pursuant to the bill, the bank could deduct as a charitable contribution

(subject to the percentage limitation) an amount equal to the combined loss and charitable deductions that would have been available had the bank that first sold the instrument at a loss and then donated the proceeds to charity.

Other tax consequences may be different, however. For example, in the case of a loss sale followed by a contribution of the sale proceeds, only the proceeds of the sale are subject to the percentage limitations on charitable contribution deductions.

A qualified debt contribution is defined under the bill as a contribution of a certain type of debt instrument to a qualified organization with respect to which the taxpayer receives from the donee a written statement that the instrument (or the proceeds therefrom) will be used for an international conservation purpose.

The contributed debt instrument must evidence a loan to certain foreign states eligible for World Bank or International Development Association financing. It is intended that a country be included in the eligible category if it is a "Part II" member of the International Development Association (IDA). Currently there are approximately 114 members in this category, which includes the IDA members whose subscriptions and contributions to IDA may not be used by IDA for projects financed by IDA and located outside the territories of the member (except by agreement between the member and IDA).

The bill defines "qualified organization" by reference to existing law applicable to qualified conservation contributions, i.e., to mean certain types of public charities and Federal, State, or local governments (sec. 170(h)(3)).

Donation purpose

An international conservation purpose means the expenditure in or with respect to the country that is either the obligor of the debt instrument or the residence of the obligor, for one or more of the following purposes:

(1) the preservation of land areas for outdoor recreation by, or the education of, the general public;

(2) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem;

(3) the support of museum, park, conservation, and nature and conservation education personnel and programs;

(4) the facilitation of cohabitation between inhabitants of a particular area and fish, wildlife, plant, or similar

ecosystems in the area;

(5) research and experimentation in connection with any of the purposes described above; and

(6) support of international, national, and local governmental programs to accomplish any of the above purposes.

Information returns

The bill also provides that the rules requiring donees to file information returns regarding their dispositions of certain donated property would not apply to the redemption of a qualified debt instrument that qualifies for deduction under the bill.

Effective date

The amendments made by the bill would apply to contributions after the date of enactment.